AMERICAN ACADEMY *of* ACTUARIES

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October 28, 2014

Mike Boerner
Chair, Life Actuarial Task Force
National Association of Insurance Commissioners

Dear Mike:

The American Academy of Actuaries[1] Life Illustrations Work Group (Work Group) appreciates the opportunity to comment on the two recently exposed Actuarial Guidelines for Illustrations of Indexed Universal Life (IUL) products.

According to the Life Illustration Model Regulation, its purpose is to: "provide rules for life insurance illustrations that will protect consumers and foster consumer education." In our view, neither of these proposals fully meets the needs of the consumer or provides guidance to the illustration actuary. Additionally, we believe that consumers would benefit from IUL education that extends beyond the illustration (for example, the NAIC could enhance the buyer's guide with additional information specific to IUL policies).

The two actuarial guidelines were proposed to address current concerns with IUL illustrations, although they take two separate, very different approaches to accomplish their goals. It should be noted that the Work Group has not performed a thorough review of technical practices, nor has it fully evaluated the impacts of the proposals on illustration content, the consumer, or the work of the illustration actuary.

We believe the best way to address the issues that exist with both IUL products and other illustrated products is by updating the Life Illustration Model Regulation. That said, we have provided our specific comments on both the ACLI Proposal and the Coalition Alternative Proposal below.

<u>ACLI Proposal</u>
The ACLI proposed guideline prescribes a method for determining the maximum crediting rate shown in the illustration. It specifically limited that rate to no higher than (a) the average

[1] The American Academy of Actuaries is an 18,000+ member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

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crediting rate using the current index parameters and a 25-year look-back period, (b) the rate used for demonstrating self-support, and (c) 10%. This proposal also includes additional required charts of actual historical credited rates in order to show variability that can occur when the product's credited rate is linked to a particular index and crediting method.

In addition to the issues we discussed in our May 23, 2014 letter on the ACLI's proposal, we have these concerns:

- The use of current indexing parameters (nonguaranteed caps, participation rates, etc.) that are based on current option costs, combined with historic index experience creates a mismatch of assumptions. The resulting hypothetical credited interest rates displayed can either overstate or understate the average illustrated crediting rates relative to what a consumer may have received under a company's non-guaranteed element framework over the historical period. It may be helpful to bring more consistency into the components of the methodology. (The same type of mismatch is true in the indexed annuity illustration regulation; however, the impact is less severe due to the shorter historical horizon used and commonly lower option budgets. Some thought should be given to the issue of consistency between indexed UL and indexed annuity illustration methodologies and manner of presentation).

- The ACLI proposal does not address how, or if, the maximum credited rate impacts the experience assumptions underlying disciplined current scale (DCS) testing. This includes the relationship between the maximum credited rate and the derivative returns underlying the DCS investment return assumption. The proposal should provide guidance on how adjustments to the illustration's maximum credited rate should be reflected in the DCS testing.

- For indices that have existed between 10 and 25 years, being able to use the average return for that index seems to contradict the recommended 25-year period. If 25 years is the correct historical period, consider adding guidance on how indices with less than 25 years may be able to meet a 25-year historical view regardless of duration of availability of the index. Do not discourage innovation of new indices, but be consistent with the approach of the recommended 25-year period.

- Further explanation of the use of a 10% cap on illustrated interest crediting rates would be helpful. If the underlying method is trusted, is a cap truly necessary?

- Since a level index return is shown in the basic illustration, it is important that the potential variability of credited interest be conveyed in some fashion. Although Table A does attempt to address this issue, it would be more understandable to the consumer if the 25-year average return shown in Table A were aligned with the credited rate in the illustration.

- While additional information is suggested for products with loan features, we do not believe that the proposal goes far enough to educate the consumer on the nature of the current environment and future of policy loan charges and credits when the policy loan interest rate is variable. Demonstration of loan arbitrage (credited interest higher than loan charge) and future reliance on this arbitrage may cause disappointment in the policyholder. This problem can exist on more than just IUL, and should be addressed in an industry-wide fashion rather than just IUL products.

Coalition Alternative Proposal

This alternative guideline approaches the issue by providing a specific formula for determining the underlying investment assumption that would be used when testing the disciplined current scale for the lapse and self-support requirements of the Model. The proposal defines the investment return assumption based upon the general account fixed income yields for the asset block, plus the addition of a percentage to represent gains on the assets invested in options. This percentage is based upon "Indexed Derivative Returns." The Indexed Derivative Returns are to be based on a "sound theoretical basis." This proposed guideline also includes a fixed 12% cap on the resulting Index Derivative Return.

We have specific concerns/questions regarding the Coalition Alternative Proposal:

- How will Indexed Derivative Return be calculated? As stated in the proposed guideline it "should be justified under a reasonable theoretical basis." We believe that more specificity is needed in this area. Additional expert opinions would be helpful to further clarify and develop this concept to give better guidance to the illustration actuary.

- Complications in developing an appropriate assumption for a block of policies may occur if products are designed with multiple minimum interest rate guarantees (e.g., primary and secondary) because the formula requires the subtraction of the "guaranteed interest rate," and does not start from the first principle of developing the investment return of all the assets underlying the block of policies.

- The justification for the 12% maximum return is not clear. If the underlying method is trusted, is a cap truly necessary?

- Given that a level interest credited rate is generally illustrated (regardless of whether or not it is IUL), additional disclosure might help the consumer understand that IUL differs from non-indexed products due to the higher potential for greater variation in crediting interest crediting rates from year to year. Showing historical volatility and variable loan rates may provide education to the consumer on how the policy may perform. We do see value in increased education to the consumer.

- By creating an actuarial guideline that affects a DCS investment return experience factor, there may be potential to create a conflict with existing guidance. Further clarifications and definitions may be needed for an actuary to deal with possible conflicts.

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We hope these comments are helpful. Please contact Brian Widuch, the Academy's life policy analyst (widuch@actuary.org; 202-223-8196), if you have any questions or would like any further assistance. The Academy Life Illustrations Work Group would be willing to offer its services in any additional work that LATF is contemplating while it considers the proposals or other alternatives that will impact the work of an illustration actuary.

Sincerely,

Linda Rodway, MAAA, FSA
Chairperson
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